

## **EXPOSURE FEE ADVICE**

### **BACKGROUND**

Since 1978, Ex-Im Bank has worked with the Organization for Economic Cooperation and Development (OECD) Arrangement. We have worked to minimize official export credit subsidies to ensure that buying decisions are made on factors other than the financing provided by official export credit agencies (ECAs). There have been many achievements, including the elimination of trade-distorting tied aid from a variety of sectors and the establishment of market-related minimum interest rates. The establishment of minimum fees that ECAs must charge for risk is another step in our efforts to give U.S. exporters a level playing field and to minimize costs to taxpayers.

One of the last major uncovered aspects of official export finance support was the fees charged by ECAs for the risk that a transaction would not be repaid. We changed our exposure fee system in concert with all major ECAs to charge no less than the OECD minimum risk fees for every market. Ex-Im Bank set its exposure fees at the lowest levels allowed for sovereign transactions. This means that for sovereign risk transactions, no other ECA will be able to provide support at a more advantageous rate than Ex-Im Bank. Like every aspect of the Arrangement, the new system only affects transactions with at least a two-year repayment term.

"Permitted Exceptions," i.e., conditions that insulate Ex-Im Bank from country risk, do permit lower than minimum OECD benchmark fees. Although an agreed list of such exceptions is not yet available, examples of situations that may qualify include off-shore escrow accounts and acceptable third country guarantors.

### **WHAT RISK ELEMENTS ARE INCLUDED?**

The basic sovereign risk exposure fee, i.e., the minimum fee for a country, is determined by five variables: exposure fee level of the country, percentage of cover, the "quality" of product provided, and the length of the drawdown and repayment periods.

#### **1. Ex-Im Bank Exposure Fee Level**

Exposure fee levels (1-7) have been established for all markets where it is possible for Ex-Im Bank to provide cover, i.e., not for markets where Ex-Im Bank is prohibited by law from providing support. Since the minimum exposure fee for a country is determined by the OECD country classification, Ex-Im Bank exposure fee levels are consistent with OECD country classifications. For markets which have not been classified by the OECD process, Ex-Im Bank translates the U.S. Government's Interagency Country Risk Assessment System (ICRAS) classification (based on eleven categories) into an exposure fee level.

**2. Percent of Cover, e.g., 90%, 95%, 100%**

The OECD norm for coverage is 95%. Ex-Im Bank's normal coverage is 100% for medium-term insurance, guarantees and loans. A premium is applied for the additional coverage. Ex-Im Bank is in the process of evaluating the merits of offering a long-term insurance product which may provide less than 100% cover.

**3. Products Offered** (from least to most expensive)

There are three quality levels of financing product:

**a. Below Standard** (conditional insurance product which does not cover post-default interest) Ex-Im Bank does not currently offer a "below standard" product.

**b. Standard** (conditional insurance product which covers post-default interest)  
Ex-Im Bank's existing insurance product quality is "standard."

**c. Above Standard/Superior** (unconditional coverage)  
Guarantees and direct loans are priced as "above standard." (The Arrangement would allow Ex-Im Bank to price the direct loan as a "standard" product, but Ex-Im Bank decided to price both equally in order to not introduce a bias in favor of direct loans over guarantees.)

**4. Length of the Drawdown Period**

Ex-Im Bank's exposure fees are sensitive to risk covered during the drawdown period, which is defined as the number of months from the first drawdown to the starting point of the credit under the approved transaction. (See Calculation of Drawdown Period Fact Sheet.)

**5. Length of the Repayment Period**

Ex-Im Bank's exposure fees are sensitive to the length of the repayment period, expressed in half-year increments. The repayment period is defined as the time from the starting point of credit to the final repayment. (See Repayment Terms Fact Sheet.)

Ex-Im Bank's exposure fees are also sensitive to two additional decision items, whether or not the exposure fee is to be financed and when the exposure fee is paid.

**6. Financing the Fee**

Ex-Im Bank allows the exposure fee to be financed -- albeit at a higher rate than if not financed. Also, it remains possible to finance 85% of the exposure fee at the lower rate, i.e., if the exposure fee has been subsumed in the contract value of the exports being covered.

## 7. **Timing of Exposure Fee Payment**

Ex-Im Bank allows the choice of paying the entire exposure fee "up-front" at or before the time of first drawdown, or on a pro-rata basis as the loan is drawn down. The exposure fee will be higher if paid as disbursed to take account of the time value of money.

There are four options for paying the exposure fee:

- a. **Fee Financed** - either (1) *paid as drawn down* (typical for Ex-Im Bank; nominally highest fee option) or (2) *paid up front* (the fee is included in the promissory note with Ex-Im Bank's guarantee, but the lender pays the entire fee amount to Ex-Im Bank when it requests the first draw down).
- b. **Fee Not Financed** - either (3) *paid as drawn down* (the fee is not included in the promissory note but paid, in parts, at each draw down), or (4) *paid up front* (condition precedent; OECD "baseline fee," nominally lowest fee option).

## **HOW ARE NON-SOVEREIGN RATES DETERMINED?**

Since the OECD fee arrangement stipulates minimum fees per country, i.e., sovereign risk fees, Ex-Im Bank has established a series of "transaction risk increments" which determine the exposure fees for non-sovereign transactions. The non-sovereign exposure fees attached to the risk increments are 0-50% higher than a country's sovereign fee, i.e., a non-sovereign deal which is risk-rated in "increment 1" has an exposure fee which is 10% higher than the sovereign fee for that market. Fees for non-sovereign transactions cannot be less than the sovereign fee, except for permitted exceptions, and when "political risk only" cover is provided (these transactions are priced at transaction risk increment "-1", which is 10% lower than the sovereign rate).

Transaction risk increments are generally determined by how risky a transaction is relative to the sovereign. Hence, the exposure fee for a transaction that is rated 2 risk levels higher than the sovereign under ICRA S is that of "risk increment 2" for the country in question (or 20% higher than the sovereign fee).

In practice, medium-term transactions have pre-determined risk increments assigned to them, much like the previous system which assigned standard fee levels. For example, transactions under \$10 million for Mexican financial institutions are priced at transaction risk increment "0" (the same as sovereign) based on Ex-Im Bank's current analysis of the Mexican banking sector. Under the previous ICRA S-based system, these transactions were priced at "fee level 5" – the same as the sovereign.

Generally, there are not any pre-determined risk increments assigned to non-sovereign long-term transactions. Although the fee calculator does show the range of possible pricing, more

specific exposure fee indications for long-term transactions can be obtained by looking at the exposure fee advice sheet for the country in question. These sheets make use of either private risk ratings (if available) or key financial ratios and indicators which allow a transaction risk increment to be identified.

## **HOW IS COUNTRY COVER POLICY DETERMINED?**

Ex-Im Bank uses its Country Limitation Schedule (which remains based on ICRAS classifications) to determine country cover policy. Hence, the fact that the OECD agreement provides rates for countries where Ex-Im Bank is closed has no bearing on Ex-Im Bank's willingness to provide cover in a given market or for a particular transaction.

## **HOW DO OUR CURRENT PRODUCTS FIT IN THIS SYSTEM?**

### **Short-Term Insurance**

These fees do not change. The arrangement applies only to transactions with repayment terms of at least two years.

### **Medium-Term Products**

For medium-term insurance, we offer 100% coverage, standard quality, and the option to have fees financed or not; fees are paid up front. For direct loans, we offer 100% coverage, above standard quality, and the option to have fees financed or not; fees are paid as disbursed. We will offer an up-front payment option for fees. (Fees on canceled authorized amounts will be refunded.) For guarantees, we offer 100% coverage, above standard quality, and the option to have fees financed or not; fees are paid as disbursed. We offer an up-front option.

### **Long-Term Products**

We offer the same on long-term loans and guarantees as we do on medium-term products. The creation of a long-term insurance policy is being studied. Other changes that may be considered are options for lower-percentage coverage on all medium- and long-term transactions.

### **OECD Baseline**

The current OECD baseline product offers 95% coverage and standard quality; fees are not financed and are paid up-front.

## **HOW DO I GET AN EXPOSURE FEE?**

You have three options for obtaining an exposure fee once you know all of the variables mentioned above.

1. Internet: <http://www.exim.gov> Country Information.
2. Calculator on disk: request a free disk from Ex-Im Bank at 202-565-3912. Country fee

level charts can be purchased.

3. Call Ex-Im Bank's Business Development at 1-800-565-EXIM (3946).

## **INSTRUCTIONS FOR USING EXPOSURE FEE ADVICE TABLES**

Ex-Im Bank provides two Exposure Fee Advice Tables for every market in which Ex-Im Bank is open for business. The first table pertains to public sector credits, i.e., credits in which the obligor or guarantor is a public sector entity, the second to private sector credits, i.e., credits in which the obligor or guarantor is a private sector entity. Ex-Im Bank generally defines an entity as being "public sector" when the government directly or indirectly owns fifty percent or more of the entity.

The instructions are presented step-by-step. Once you reach the step that provides the relevant exposure fee level (which is the same for all transactions in a given market) and transaction risk increment (which is specific to the transaction), you need not proceed to subsequent steps.

Although the exposure fee level will always be known for all transactions in a given market, in determining the appropriate transaction risk increment, Ex-Im Bank's assessment of the credit's strengths, weaknesses, and uncertainties may lead to an adjustment from the transaction risk increment indicated on the table, particularly with respect to transactions covered by Steps 3 and 6.

- Step 1** If your transaction involves a sovereign borrower/guarantor, e.g., Ministry of Finance or equivalent which conveys the country's full faith and credit, the transaction risk increment is given under section A on the "Public Sector Credits" table.
- Step 2** If your transaction involves political-only cover for a private sector transaction, the transaction risk increment is given under section B on the "Private Sector Credits" table.
- Step 3** If credit ratings and/or market spreads for the borrower/guarantor of the transactions are available, Ex-Im Bank will assign a transaction risk increment based largely on this information, using sections C 1 and C 2 of the Fee Level Chart. Ex-Im Bank will consult S&P (212-208-1527) and Moody's (212-553-0300). For financial institutions, Ex-Im Bank will also consult IBCA (212-687-1507) and subscription services such as Thompson Bankwatch Capital Intelligence and BREE. In a small number of cases, Duff & Phelps (312-263-2610) and Fitch (212-905-0582) will provide ratings. Ex-Im Bank may accept ratings from local rating agencies, if these agencies benchmark to S&P or Moody's ratings. Ex-Im Bank will also examine recent credit spreads on internationally traded debt. Sometimes, multiple ratings/spreads will yield a range of possible transaction risk increments. If so, Ex-Im Bank will evaluate which transaction risk increment is most appropriate, as part of its assessment of a credit's strengths,

weaknesses, and uncertainties. In the majority of cases, the final transaction risk increment will fall within the range of transaction risk increments indicated by the available rating and spread information.

- Step 4** If your transaction's financed/insured amount is \$10 million or less (excluding the exposure fee), the transaction risk increment generally will be that given under section D1 or D2 of the Exposure Fee Advice Tables. The transaction risk increment may be lower or higher if Ex-Im Bank has pre-approved a transaction risk increment for the borrower/guarantor.
- Step 5** If the borrower/guarantor for the credit is one of the country's largest profitable financial institutions, but is not rated by a credit rating agency, the transaction risk increment is given under section E on the appropriate (public/private) Exposure Fee Advice Table. To qualify, a financial institution must meet two tests: (1) total assets must comprise at least 1/10th of the country's domestic credit, as reported on line 32 of the IMF's "International Financial Statistics"; and (2) net income/assets must exceed 1.00 percent on average over the last two years.
- Step 6** If the transaction's borrower/guarantor is not rated by a credit rating agency and does not qualify under Step 5, Ex-Im Bank will assign a transaction risk increment using section F1 or F2 on the Exposure Fee Advice Tables as a guidepost for a possible transaction risk increment. Sections F1 and F2 give guidepost transaction risk increments for combinations of key ratios, using year-end data from independently audited financial statements. For definitions of the terms used in these ratios, see Explanation of Terms Used in Section F of the Fee Advice Tables.

Section F1 covers credits with borrowers/guarantors other than financial institutions; the guidepost transaction risk increment is based on combinations of two key ratios. Section F2 covers financial institutions; the guidepost transaction risk increment is the simple average of the transaction risk increments for five key ratios, rounded to the nearest whole number. In assigning the transaction risk increment, Ex-Im Bank will evaluate potential adjustments to the guidepost transaction risk increment as part of its comprehensive assessment of a credit's strengths, weaknesses, and uncertainties.

### **Small Transactions**

A "small transaction" is a medium-term transaction with a financed or insured amount of \$10 million or less, excluding exposure fee or premium.

Ex-Im Bank has developed specialized procedures for evaluating financial risk in small transactions. They are designed to promote efficiency and maintain credit quality by limiting and standardizing the scope of financial evaluations. Using these procedures, Ex-Im Bank is able to prudently accept more small transactions without repayment guarantees. Questions may be directed to Business Development, (202) 565-3900.

## **Risk Assessment**

Small transactions need to comply with all Ex-Im Bank policies related to the extension of credit. Assuming the small transaction qualifies for support, Ex-Im Bank will then perform its risk assessment to determine (1) whether or not reasonable assurance of repayment exists, and (2) the appropriate transaction risk increment.

Ex-Im Bank will use the following sources of information in determining reasonable assurance of repayment on small transactions:

- Credit ratings and market spreads
- Credit agency and bank references
- Historical financial statements
- Ex-Im Bank's credit experience with the borrower/guarantor and its industry
- Ex-Im Bank's credit experience with the borrower/guarantor and its industry

Ex-Im Bank will generally review only the information listed above, and not such information as market studies or cash flow forecasts. While the risk assessment process for large and small transactions is the same, the difference is in the narrower scope of information reviewed for small transactions.

## **Determination of the Transaction Risk Increment**

The determination of the transaction risk increment for small transactions will vary depending on the type of risk under consideration. For sovereign and political only risk transactions, Ex-Im Bank will generally review only the status of the borrower's/guarantor's payments on its Ex-Im Bank obligations. For all other small transactions, Ex-Im Bank will review available credit ratings and market spreads provided by the applicant to determine the appropriate transaction risk increment, using Step 3. If reliable ratings or spreads are not provided, Ex-Im Bank generally will assign the transaction risk increment shown in section D of the Exposure Fee Advice Tables. If Ex-Im Bank has pre-approved a transaction risk increment for the credit, the pre-approved transaction risk increment applies. Contact the Business Development Division to determine if a transaction risk increment has been pre-approved.

Ex-Im Bank does not require independently audited financial statements for transactions when the financed/insured amount is \$1 million or less, excluding the exposure fee or premium, provided the unaudited statements are accompanied by an acceptable explanation of accounting principles used in their preparation. In such cases, if Ex-Im Bank determines that reasonable assurance of repayment exists, the applicable transaction risk increment is shown in section D of the Exposure Fee Advice Tables.

## Special Notes

If Ex-Im Bank or other creditors have had negative payment experience with the borrower/guarantor, a significantly higher transaction risk increment may be applied. Transactions in the smallest developing-country economies, as designated on their Fee Level Chart, may incur a fee level penalty if the transaction could create a significant net foreign exchange burden on the local economy.

### EXPLANATION OF TERMS USED IN SECTION F OF THE EXPOSURE FEE ADVICE TABLES

#### For Unrated Borrowers/Guarantors Other Than Financial Institutions:

**Debt** is current maturities of long-term debt and leases + non-current maturities of long-term debt + capital leases + short-term debt (including notes payable and supplier credit contractual obligations). Note: If the proposed Ex-Im Bank financed transaction will increase the company's outstanding debt by at least 25 percent, Ex-Im Bank will re-estimate the two ratios on a pro forma basis, taking into account the increase in debt.

**Tangible Net Worth** is paid-in capital stock + preferred stock + retained earnings - treasury stock - minority interest - intangible assets, e.g., goodwill, patents, licenses. Note: Tangible net worth should also include reserves for revaluation or monetary correction as well as for foreign exchange gains/losses, if these are reported as net worth items.

**Operating Cash Flow** (for each of the last two years) is net income -- extraordinary items - net non-operating income + non-cash charges, e.g., depreciation -- the increase (or + the decrease) in net non-cash working capital. Note: In calculating operating cash flow Ex-Im Bank may make adjustments for any non-recurring or unusual developments affecting the operating cash flow.

#### For Unrated Financial Institution Borrowers/Guarantors:

**Assets** are as reported + off-balance sheet acceptances and rediscounts.

**Shareholders' Equity** is paid-in capital stock + preferred stock + capital surplus + retained earnings + capital reserves - minority interest + adjustment for cumulative effect of foreign currency translation - treasury stock.

**Net Income** is as reported.

**Borrowed Funds** are interbank borrowings + notes/bills/bonds.

**Net Loans** are loans and advances - general and specific loan loss reserves.



**Liquid Assets** are cash + short-term marketable and trading securities + government securities + due from banks.

**Reserves** are general and specific reserves available to absorb loan and other credit losses.

**Non-Performing Assets** are assets which are not producing current income + assets involving a high probability of restructuring or loss of principal. Note: If non-performing assets are not reported, or if they are under reported, Ex-Im Bank will make its own estimate.

## **MORE INFORMATION**

### **Headquarters**

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Worldwide Number	(202) 565-3946
Business Development	(202) 565-3900 Fax (202) 565-3931
TDD	(202) 565-3377
Fax Retrieval	(800) 565-EXIM, press 1, press 2
E-Mail	bdd@exim.gov
Order User's Guide	(800) 565-EXIM, ext. 3912
Seminars	(800) 565-EXIM, ext. 3912

### **Regional Offices**

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Mid-Atlantic - Washington, DC	(202) 565-3940	Fax (202) 565-3932
Southeast - Miami	(305) 526-7436	Fax (305) 526-7435
Midwest - Chicago	(312) 353-8081	Fax (312) 353-8098
Southwest - Houston	(281) 721-0465	Fax (281) 679-0156
West - Long Beach	(562) 980-4580	Fax (562) 980-4590
<i>Satellite</i> - San Jose, CA	(408) 271-7300 ext. 104	Fax (408) 271-7307
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